



The Commonwealth of Massachusetts

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 03-47-B (Phase II)

Petition of Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company, d/b/a NSTAR Electric, and NSTAR Gas Company for approval of tariffs to provide recovery for costs associated with their obligations to provide employees pension benefits and post-retirement benefits other than pensions.

APPEARANCES: Robert Keegan, Esq.

Keegan Werlin, LLP

21 Custom House Street

Boston, Massachusetts 02110

FOR: BOSTON EDISON COMPANY

CAMBRIDGE ELECTRIC LIGHT COMPANY

COMMONWEALTH ELECTRIC COMPANY

NSTAR GAS COMPANY

Petitioners

Thomas F. Reilly, Attorney General

By: Alexander Cochis

Assistant Attorney General

Utilities Division

Public Protection Bureau

200 Portland Street

Boston, Massachusetts 02114

Intervenor

I. INTRODUCTION AND PROCEDURAL HISTORY

On October 31, 2003, the Department of Telecommunications and Energy (“Department”) approved an annual reconciling adjustment mechanism regarding pension and post-retirement benefits other than pension (“PBOP”) costs, including carrying charges, not recovered in base rates (“PAM”) for Boston Edison Company (“BECo”), Cambridge Electric Light Company (“Cambridge”), Commonwealth Electric Company (“ComElectric”), and NSTAR Gas Company (“NSTAR Gas”) (together, “Companies”). Boston Edison Company/Cambridge Electric Light Company/Commonwealth Electric Company/NSTAR Gas Company, D.T.E. 03-47-A (2003). Pursuant to D.T.E. 03-47-A, the Companies submitted tariffs implementing the PAM on December 1, 2003, to become effective on January 1, 2004 (“Compliance Filing”). The Companies also proposed pension adjustment factors (“PAF”) for use in the PAM to take effect on that same date of \$0.00089 per kilowatt-hour (“KWH”) for BECo, \$0.00124 per KWH for Cambridge, \$0.00076 per KWH for ComElectric, and \$0.0075 per therm for NSTAR (Exh. NSTAR-1, at 1, ln. 36). On December 24, 2003, the Department determined that further investigation of the Compliance Filing would be necessary, but approved, subject to reconciliation, the Companies' tariffs and associated rate changes. D.T.E. 03-47-B (2003).

The Department docketed the investigation regarding the Compliance Filing as D.T.E. 03-47-B (Phase II). On December 9, 2004, the Department conducted an evidentiary hearing, at which the Companies sponsored the testimony of Michael F. Farrell, assistant controller and director of accounting for NSTAR Electric and Gas Corporation. The

evidentiary record includes 40 exhibits and responses to four record requests. The Companies filed a brief on December 17, 2004 (“Companies Brief”) and the Attorney General filed a brief on December 18, 2004 (“Attorney General Brief”). The Companies filed a reply brief on December 21, 2004 (“Companies Reply”).

In this Order, we first describe the operation of the PAM as proposed by the Companies and next discuss the positions of the parties with regard to the following issues: (1) reviewability of the PAM; (2) transmission-related pension and PBOP expense; (3) carrying charges on prepaid pension and PBOP balances incurred during the first eight months of 2003; and (4) the effects of the Medicare Prescription Drug Improvement and Modernization Act of 2003 (“Medicare Act of 2003”) on PBOP obligations.

II. OPERATION OF THE PENSION ADJUSTMENT MECHANISM

The PAM operates in this way. A charge or credit calculated on the basis of an approved PAF would be collected from, or refunded to, ratepayers through the KWH delivery charge for BECo, Cambridge, and ComElectric, and through the Local Distribution Adjustment Clause for NSTAR Gas (Exh. NSTAR-1, Compliance Tariffs M.D.T.E. No. 109 (Boston Edison Company), M.D.T.E. No. 209 (Cambridge Electric Light Company), M.D.T.E. No. 309 (Commonwealth Electric Company), and M.D.T.E. No. 406 (NSTAR Gas Company)). The PAF is calculated annually and applied separate for each company. For any year (“year_x”), the PAM formula may be stated thus:

$$PAF_x = (RA_x + cc(URD_x + APPA_x - DTA_x) + PPRA_x) / FKWH_x \text{ or } Ftherm_x$$

Where RA_x = Reconciliation Adjustment Amount for year_x, representing one-third of the Unamortized Reconciliation Deferral as the end of the prior year

- cc = Cost of Capital, representing the tax-effected weighted average cost of capital as most recently approved by the Department for each company; currently set for each of the companies at 10.88 percent until its next general rate case
- URD_x = Unamortized Reconciliation Deferral for year_x, representing the amount of the Reconciliation Deferral that has not already been collected in retail rates. At the beginning of year_x, the Unamortized Reconciliation Deferral is the sum of: (1) the Unamortized Reconciliation Deferral at the beginning of the prior year; plus (2) the Reconciliation Deferral for the prior year; minus (3) the Reconciliation Adjustment for the prior year
- APPA_x = Average Prepaid Amount for year_x, representing one-half the sum of: (1) the prepaid pension and PBOP amount recorded on the individual company's books as of the beginning of the prior year; and (2) the pre-paid pension and PBOP amount recorded on the individual company's books as of the end of the prior year
- DTA_x = Deferred Tax Amount for year_x, representing the deferred taxes associated with: (1) the average prepaid pension and PBOP amount; and (2) the URD at the end of the prior year
- PPRA_x = Past Period Reconciliation Amount for year_x, representing the difference between the PAM revenue forecasted for year_{x-1} and the amount of PAM revenue actually received in the year_{x-1}, multiplied by the prime interest rate
- FKWH_x = Forecast KWH, representing forecast electric sales to distribution customers for the upcoming calendar year
- Ftherms_x = Forecast Therms, representing forecast gas sales to distribution customers for the upcoming calendar year

(See, Exh. NSTAR-1, Compliance Tariffs M.D.T.E. No. 109, M.D.T.E. No. 209, M.D.T.E. No. 309, and M.D.T.E. No. 406).

III. POSITIONS OF PARTIES

A. Attorney General

The Attorney General argues that the Department should either reject the Compliance Filing and its tariffs or adopt a number of adjustments to the Companies' calculations (Attorney General Brief at 1). According to the Attorney General, the Companies have sought approval of a tariff formula containing complicated variables and inputs that themselves contain a considerable degree of subjectivity (Attorney General Brief at 1-2). The Attorney General contends that this subjectivity renders the PAM ill-suited for a reconciliation mechanism (Attorney General Brief at 2).¹

The Attorney General also maintains that the complexity and subjectivity of the PAM formula can lead, and has actually led, to material computation errors. First, the Attorney General argues that the Companies failed to credit ratepayers for \$10.3 million in carrying charges on prepaid pension obligations associated with electric transmission (Attorney General Brief at 2, citing Exh. AG 1-4 (Supp.); Tr. at 18-19). Second, the Attorney General argues that the Companies should be precluded from recovering \$6.625 million in carrying charges on prepaid pension and PBOP balances incurred during the first eight months of 2003, during which time the Companies were subject to a distribution rate freeze approved in Boston Edison Company/Commonwealth Energy Acquisition, D.T.E. 99-19 (1999) (Attorney General Brief

¹ The Attorney General contrasts this situation with the operation of the Cost of Gas Adjustment Clause, which is designed to pass through actual gas costs incurred by local distribution companies (Attorney General Brief at 2).

at 2).² The Attorney General reasons that it would be consistent with the Department's decision in D.T.E. 03-47-A to exclude pension and PBOP costs incurred during the rate freeze period to also exclude associated carrying charges on prepaid pension and PBOP balances (id.). Finally, the Attorney General argues that the Companies failed to recognize the anticipated reduction in PBOP expense resulting from the passage of the Medicare Act of 2003, as would be required under Paragraph 40 of Statement of Financial Accounting Board Standards No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions" ("SFAS 106") (Attorney General Brief at 2-3, citing Exh. AG 1-29; Tr. at 67). Thus, the Attorney General proposes that the Department order the Companies to recognize a \$1.75 million change in PBOP expense arising from the Medicare Act of 2003 (Attorney General Brief at 3).

The Attorney General contends that the Department should, at a minimum, review a company's earnings to determine whether a general rate increase, as represented by the PAM, is necessary to ensure that resulting rates would be just and reasonable. According to the Attorney General, the Companies have failed to make this showing and are therefore not entitled to additional pension recoveries above the levels already included in base rates (Attorney General Brief at 3-4).

² This balance represents two-thirds of \$9,937,000 in average prepaid pension and PBOP balances for BECo, covering the period from January 1, 2003 through the end of the rate freeze on August 31, 2003 (Exh. NSTAR-1, Compliance Filing at 1, ln. 19). Using the Attorney General's analysis, the average prepaid pension and PBOP balance of \$16,127,000 for all of NSTAR's gas and electric distribution subsidiaries would warrant a total reduction of approximately \$10,751,000.

B. Companies

The Companies maintain that the Compliance Filing comports with the terms of D.T.E. 03-47-A, and that their PAM factors have been calculated correctly (Companies Brief at 3-4). In addition, the Companies argue that the Compliance Filing addresses, to the extent applicable, the Department's directives in Fitchburg Gas and Electric Light Company, D.T.E. 04-48 (2004) (Companies Brief at 5-7; Companies Reply at 5). According to the Companies, a company's burden in a compliance filing following a Department-approved rate change is to show that (1) the tariffs accurately implement the directives of the Department, and (2) the calculations made to compute the rates are accurate and consistent with the rate tariffs (Companies Brief at 2). The Companies maintain that they have met this burden, and that the Department should reject the Attorney General's contentions as an untimely motion for reconsideration of the Department's decision in D.T.E. 03-47-A (Companies Reply at 2).

The Companies argue that the Attorney General's objections to the complexity of the PAM formula actually go to assumptions that underlie the calculation of pension and PBOP obligations under Statement of Financial Accounting Board Standard No. 87, "Employer's Accounting for Pensions" ("SFAS 87") and SFAS 106 (Companies Reply at 2). The Companies contend that the assumptions behind the calculation of pension and PBOP costs are developed through a rigorous process based on actuarial expertise, industry knowledge, and the Companies' own input, and that the PAM's reconciliation features will account for differences between actual and projected costs in accordance with the requirements of both SFAS 87 and SFAS 106 (Companies Brief at 8; Companies Reply at 2-3). The Companies

maintain that the Attorney General's concerns on this issue were raised and considered in D.T.E. 03-47-A, and that his arguments constitute an attempt to seek reconsideration of the Department's order in D.T.E. 03-47-A (Companies Reply at 3).

Concerning the specific issues raised by the Attorney General, the Companies first contend that they have separately identified and accounted for pension and PBOP costs associated with transmission service (Companies Brief at 6). According to the Companies, transmission-related pension and PBOP costs are collected from transmission customers in accordance with tariffs approved by the Federal Energy Regulatory Commission ("FERC"), and are separate from pension and PBOP costs collected through base distribution rates (Companies Brief at 6, citing Exh. AG 2-1). The Companies maintain that, because pension and PBOP costs presently being collected through transmission and distribution rates have been deducted from total pension and PBOP costs, no further adjustment is warranted for transmission-related pension and PBOP costs (Companies Brief at 6-7, citing Exhs. NSTAR-1, at 1, ln. 3; AG 1-4, Att. at 6).

Regarding the computation of carrying charges on prepaid pension and PBOP balances for 2003, the Companies state that they have computed these charges in accordance with the Department's directives (Companies Reply at 3). In support of their positions, the Companies cite the language of D.T.E. 03-47-A at 45-46:

Further, carrying costs will be allowed on the average annual prepaid pension balance expense and the unamortized deferred pension and PBOP expenses, net of deferred income taxes.

There will be no carrying costs on the deferred pension and PBOP expense recorded by the Companies during the first 8 months of 2003 as discussed in Section VI.C.3 of this Order.

According to the Companies, reading these passages together with the rest of the Department's discussion in D.T.E. 03-47-A, makes it clear that the Department intended to provide for an exception to our denial of recovery of pension and PBOP costs incurred during the rate freeze period; and, accordingly, carrying charges associated with prepaid pension and PBOP balances are eligible for recovery through the PAM (Companies Reply at 3).

Concerning the implications of the Medicare Act of 2003 for pension and PBOP obligations, the Companies argue that the evidence contradicts the Attorney General's contentions. The Companies state that the Compliance Filing was submitted prior to the passage of the Medicare Act of 2003, and that Paragraph 40 of SFAS 106 specifies that future changes in laws governing medical cost covered by governmental programs and other providers shall not be taken into consideration in the determination of PBOP obligations (Companies Reply at 4). Rather, the Companies state that they, along with most other companies affected by the Medicare Act of 2003, have exercised their option to await guidance from the Financial Accounting Standards Board ("FASB") on this matter during 2004, rather than attempt to predict effects during 2003 (Companies Reply at 4-5).

IV. ANALYSIS AND FINDINGS

In D.T.E. 03-47-A, the Department approved, with modifications, the Companies' proposed PAM. The Companies have filed revised tariffs and PAM factors to comply with the Department's directives in both D.T.E. 03-47-A and subsequent orders related to pension and

PBOP adjustment mechanisms. The purpose of our review in this proceeding is not to relitigate the issues raised and decided in D.T.E. 03-47-A, but rather to determine whether (1) the Companies' PAM tariffs comply with our Order in D.T.E. 03-47-A, and (2) the Companies' PAFs have been calculated accurately in accordance with the PAM tariffs.³ The Department's approval of a PAM in D.T.E. 03-47-A establishes a finding that PAFs would, upon a demonstration that they and the underlying tariffs complied with the Department's directives in D.T.E. 03-47-A, produce just and reasonable rates. In contrast, the Attorney General has not presented any evidence, aside from assertion, that the application of the proposed PAFs to the Companies' current rates would result in either overearnings or significant rate inequities -- in effect, that applying the PAFs would lead to unjust or unreasonable rates. Therefore, the Department declines to reject the implementation of PAM factors by the Companies on the basis of mere assertion without demonstration that the resulting rates fail to meet a "just and reasonable" standard.⁴

The Attorney General emphasizes the subjectivity of the actuarial studies relied upon in the PAM formula as a basis to reject the proposed PAFs. The Department has long recognized that the determination of pension and PBOP expense for ratemaking purposes is a matter inescapably subject to interpretation and thus to controversy. Massachusetts Electric

³ To the extent that the Department's directives in Fitchburg Gas and Electric Light Company, D.T.E. 04-48 (2004) apply to the Companies, those directives would be considered in evaluating the Companies' PAM computation.

⁴ If the Attorney General has reason to believe that one or more of the Companies will be earning excessive returns as a result of the addition of a PAM factor, he has recourse through a petition filed pursuant to G.L. c. 164, § 93.

Company, D.P.U. 95-40, at 44 (1995); Boston Gas Company, D.P.U. 93-60, at 213 (1993); Massachusetts Electric Company, D.P.U. 92-78, at 82 (1992). Nevertheless, judgment grounded in law and evidence is the heart of ratesetting; and pension and PBOP obligations represent expenses that must be provided for through rates.⁵ The Department has approved the use of actuarially-determined pension and PBOP expense as an input in the PAM formula. D.T.E. 03-47-A at 45. Therefore, the Department will not disallow the PAFs on the ground that the use of actuarially-determined pension and PBOP expense levels renders them unreliably flawed. That some degree of uncertainty is inherent in projection of future events does not per se render projection either unuseful or invalid.

Concerning the allocation of transmission-related pension and PBOP costs, those pension and PBOP costs attributed to the transmission functions of BECo, Cambridge, and ComElectric are collected through FERC-approved transmission rates, using a FERC-approved labor allocator that varies annually (Exh. AG 2-1; Tr. at 19, 83-84). In contrast, the level of pension and PBOP costs included in base rates does not include those costs that would be allocated to transmission functions, and thus would remain fixed between rate cases (Exh. AG 2-1). When calculating the PAM factors for BECo, Cambridge, and ComElectric, the Companies combine the pension and PBOP costs collected through transmission and distribution rates, and deduct this balance from the level of pension and PBOP costs to be

⁵ Parallels to this treatment may be found with the use of estimates and projections to determine salvage factors that are used in determining depreciation accrual rates, in recognition of the fact that such costs can not be precisely determined until after the plant has been retired and removed. Cambridge Electric Light Company, D.P.U. 92-250, at 66 (1993); Boston Edison Company, D.P.U. 1350, at 109 (1983).

collected through the respective PAM (Exhs. AG 1-4, Att. at 6; AG 2-1, Tr. at 85-86). In this way, transmission-related pension and PBOP expenses are effectively removed from a particular year's PAM factor.⁶ The Department finds that the Companies have properly excluded pension and PBOP costs related to their transmission function. Accordingly, no further adjustment is warranted for transmission-related pension and PBOP costs.

Regarding the issue of recovery of carrying costs associated with prepaid pension and PBOP balances, the Department specified in D.T.E. 03-47-A at 45-46 that carrying costs would be allowed on the average, annual, prepaid pension balance and the unamortized, deferred pension and PBOP expense, net of deferred taxes (Exh. DTE 1-1). The Department further specified that no carrying charges would be recovered on the deferred pension and PBOP expense recorded by the Companies during the first eight months of 2003.

D.T.E. 03-47-A at 46 n.34. Although the Department's Order did not explicitly state the treatment to be accorded to prepaid pension and PBOP balances that were incurred during the first eight months of 2003, the clear implication is that carrying charges associated with prepaid pension and PBOP balances incurred during the rate freeze period were to be accorded different treatment from other carrying charges. What has been inferred is what was implied

⁶ Because transmission-related pension and PBOP expense does not totally reconcile with updated transmission revenues and resulting rates, a small mismatch between transmission- and distribution-related pension and PBOP expense is possible (Tr. at 86-90). Nevertheless, the Companies represent that any such mismatch would be reconciled as part of the subsequent year's PAM filing (Tr. at 89-90). We expect that the potential for mismatch, however small it may be, to be a matter expressly addressed in each annual filing. If there is a mismatch in some later year, it must be adjusted for explicitly. If there is no mismatch, the Companies must so represent.

and intended: the Order in D.T.E. 03-47-A represents a complete statement of what was excluded from recovery.

As we noted in D.T.E. 03-47-A at 20 n.21 and 37, the Companies have followed a course encouraged by the Department's regulatory policies: that is, prepaying as much as allowed by the Federal Tax Code and doing so in order to take advantage of the tax-exempt status of Internal Revenue Service-qualified pension and PBOP plans. The prefunding of these plans allows the Companies to accumulate earnings on pension trust investments on a tax-free basis, thereby producing lower overall costs to ratepayers. Moreover, we recognize that prepayment of pension and PBOP obligations assists in ensuring sound pension plans that consequently serve to attract and retain a skilled workforce. It thus follows that this prepayment policy be recognized through the ratemaking process. Accordingly, no further adjustment is warranted in this filing for the carrying costs associated with prepaid pension and PBOP expense.⁷

Concerning the effects of the Medicare Act of 2003, SFAS 106 specifies that future changes in laws governing medical cost covered by governmental programs and other providers shall not be taken into consideration in the determination of PBOP obligations.⁸ In

⁷ Our treatment of prepaid pension and PBOP expense does not signify a change in Department policy with respect to other types of prepayments, or costs incurred during a rate freeze. See D.T.E. 03-47-A at 45 n.32. No opinion is expressed with regard to other prepayments.

⁸ We take administrative notice of all texts of FASB. See the Financial Accounting Standards Board website: <http://www.fasb.org/pdf/fas106.pdf>.

December of 2003, FASB issued Staff Position (“FSP”)⁹ No. FAS 106-1, permitting plan sponsors to elect a one-time deferral of the accounting for the Medicare Act of 2003, to remain in place until the earlier of (1) the issuance of further guidance from FASB, or (2) the remeasurement of plan assets and obligations subsequent to January 31, 2004 (Exh. AG 1-31, at 16-17; Tr. at 67-69). As permitted by FSP-FAS 106-1, the Companies elected to defer recognition of the provisions of the Medicare Act of 2003 (Exh. AG 1-26 (NSTAR Form 10-Q for quarter ending September 30, 2004)). In May of 2004, FASB issued final guidelines through FSP No. FAS 106-b; and the Companies began accounting for the effects of the Medicare Act of 2003 effective to July 1, 2004 (Exhs. AG 1-26 (NSTAR Form 10-Q for quarter ending September 30, 2004); AG 1-31, at 17). The Department finds that the Companies have properly considered the effects of the Medicare Act of 2003 in the calculation of their pension and PBOP costs for 2003. Accordingly, no further adjustment is warranted in this filing for the effects of the Medicare Act of 2003 on pension and PBOP costs.

The Department has reviewed the Compliance Filing and finds that the Companies’ proposed 2004 PAM factors for BECo (\$0.00089 per KWH), Cambridge (\$0.00124 per KWH), ComElectric (\$.00076 per KWH), and NSTAR Gas (\$0.0075 per therm) have been calculated in compliance with the Department’s directives in D.T.E. 03-47-A and D.T.E. 04-48. Specifically, the Compliance Filing: (1) reconciles the pension and PBOP expense booked in accordance with SFAS 87 and SFAS 106 with the expense amount included

⁹ FASB Staff Positions provide guidance on the implementation of FASB pronouncements.

in the Companies' base rates; (2) amortizes the reconciliation amounts over three years; (3) includes carrying costs on the average prepaid pension balance, existing reconciliation deferrals, the unamortized deferred pension and PBOP balances, and the unamortized balance of post-August 25, 2003 deferred pension and PBOP expense, net of applicable deferred income taxes; (4) excludes carrying costs on deferred pension and PBOP expense recorded during the first eight months of 2003; (5) capitalizes the PBOP transition obligation; and (6) excludes pension and PBOP costs related to transmission. The Department finds that the PAM tariffs and first annual Compliance Filing are in full compliance with the terms of D.T.E. 03-47-A, as well as with the applicable directives contained in D.T.E. 04-48.

VI. ORDER

After due notice, hearing and consideration, it is

ORDERED: That the tariff filed by Boston Edison Company with the Department on December 1, 2003, M.D.T.E. No. 109, is APPROVED; and it is

FURTHER ORDERED: That the tariff filed by Commonwealth Electric Company with the Department on December 1, 2003, M.D.T.E. No. 309, is APPROVED; and it is

FURTHER ORDERED: That the tariff filed by Cambridge Electric Light Company with the Department on December 1, 2003, M.D.T.E. No. 209, is APPROVED; and it is

FURTHER ORDERED: That the tariff filed by NSTAR Gas Company with the Department on December 1, 2003, M.D.T.E. No. 406, is APPROVED; and it is

FURTHER ORDERED: That the proposed Pension Adjustment Factors of \$0.00089 per KWH for Boston Edison Company, \$0.00124 per KWH for Cambridge Electric

Light Company, \$0.00076 per KWH for Commonwealth Electric Company, and \$0.0075 per therm for NSTAR Gas Company are APPROVED; and it is

FURTHER ORDERED: That Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company, and NSTAR Gas Company comply with any and all other directives contained in this Order.

By Order of the Department,

/s/

Paul G. Afonso, Chairman

/s/

James Connelly, Commissioner

/s/

W. Robert Keating, Commissioner

/s/

Judith F. Judson, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.